Event Transcript

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Start of Transcript

Operator: Thank you for standing by and welcome to the Oil Search Limited 2021 half year results conference call. All participants are in a listen-only mode. There will be a presentation followed by a question-and-answer session. If you wish to ask a question, you will need to press the star key followed by the number 1 on your telephone keypad. I would now like to hand the conference over to Mr Peter Fredricson, Acting CEO. Please go ahead.

Peter Fredricson: Good morning, and welcome to everyone. Thank you for taking the time to hear our presentation and to look at Oil Search's 2021 half-year results. For those of you who don't know me, I'm Peter Fredricson, the Acting Chief Executive Officer of Oil Search. I joined the Company in March of this year as Chief Financial Officer and was asked by the Board to step into the Acting CEO role when Keiran Wulff stepped down in mid-July. I'm pleased to present to you today alongside my colleagues a solid set of results reflecting our focus, strategy, and resilient operations.

Before I commence with today's presentation, I would like to draw your attention to the disclaimer. I would just mention that all dollar amounts referred to in this presentation are US dollars unless noted otherwise.

Today I have a number of Oil Search executive leadership team here with me, and I'm pleased that Beth White, Diego Fettweis, and Bruce Dingeman will all have a chance to present to you this morning. I'm sure that amongst what is a very well-aligned team with in excess of 150 years of experience in the oil and gas sector, we should be able to handle the vast majority of questions that might arise through the presentation.

I'll start with an overview of recent events and results. Firstly, on the status of the non-binding indicative merger proposal that we are currently working through with Santos. Teams from both sides are working through extensive due diligence of the information that each entity has loaded into their respective data rooms. With the consideration to be received by Oil Search shareholders being Santos shares, we have to assess the value of that consideration so that we can appropriately advise our Board and shareholders in respect of the proposal. You'll be aware that Kevin provided some timing updates last week and I'm pleased to say that we are fully aligned on that expected timing.

We have Macquarie Bank, Goldman Sachs, and Allens advising us on the proposal alongside a number of other technical advisors. Grant Samuel & Associates have been engaged to provide an independent experts' report. We are working towards a scheme of arrangement under the PNG *Companies Act*. We are working with Santos on the necessary merger implementation deed with the expectation that Oil Search shareholders will be asked to vote on the transaction prior to the end of the year. As noted when the proposal was announced, Oil Search's directors intend on unanimously recommending the proposal if the independent experts conclude that it is in the best interests of Oil Search shareholders and in the absence of a superior proposal.

Whilst there have been a number of changes at Oil Search in 2021, one thing has not changed: our purpose of delivering low-cost, high-value energy that meets society needs is front and centre for all of our people. In that regard, we have delivered some 13.5 million barrels of oil equivalent in production in the first half, exceeding our internal expectations, at a unit production cost of S$10.63 per barrel of oil equivalent, well within our target range of $10.50 to $11.50.

Notwithstanding the half year that saw significantly more COVID-19 disruption in Papua New Guinea than was experienced here in Australia during that time, we had a very successful production outcome across our operated oilfields and within the PNG LNG project which we own 29% of. Those production numbers aligned with significantly improved oil prices to deliver a strong financial outcome for the half, revenues up 7% on the previous corresponding period, with the lag effect we experience in LNG pricing to be further reflected in second half '21 revenue.

We actually had a strong first quarter from LNG pricing perspective in FY20 compared with a weaker first quarter in FY21 as the lower prices from the later part of 2020 flowed through into the first quarter of this year. The good news is that we do have that lag effect in LNG pricing flowing into a strong third quarter in FY21, so with around 70% of revenue coming from PNG LNG, we continue to have confidence about a strong full-year result in FY21.

Earnings and cash flow are all up significantly over the previous corresponding period, with the increase in cash flow in particular allowing us to maintain ongoing reduction in gearing and a return to paying dividends with $0.033 per security dividend representing a payout ratio of 49%, towards the top end of our 35% to 50% of net profit after tax policy range.

Most importantly, our safety performance in the first half 2021 is significantly improved at a TRIR of 1.02, with ongoing performance into July and August of the current year showing that outcome at less than 1.0 on a year to today's date basis.

Again, notwithstanding a number of changes and the challenge of a heightened COVID-19 operating environment, in FY21 we have continued to execute on the strategy we rolled out in November 2020. Our focus, deliver, evolve strategy is one that provides all stakeholders with clear visibility on what we are doing, how we are doing it, and where we are going. Our focus this year has been on safety and running the business to deliver increased cash flows, increased production, and reduced costs. Everything you will see from us today shows what that focus has delivered in the result that we're announcing. The focus on increased production and achieving a 40% reduction in underlying operating costs by 2023 will remain front and centre for us for the remainder of 2021 and into 2022 and 2023.

We will continue to deliver on the projects that are already contributing from a financial results perspective whilst also looking to deliver on Papua LNG FEED in 2022 and working towards completion of the Pikka FEED process to put us in a position to deliver FID off the back of an acceptable funding structure for that project. With the recent announcement by the PNG Government and Exxon that they intend to reengage on the P'nyang gas project. We look forward to contributing to the delivery of that project in the fullness of time.

What you will see later in this presentation is where Oil Search evolves to over the latter part of this decade on the back of these growth projects that we already have available to us, projects that will deliver us significant cash flow to ensure we can meet our net zero by 2050 ambitions through appropriate energy transition and carbon abatement programs in the field.

That focus on operating costs continues to deliver Oil Search strong EBITDAX margins that surpass the average of our industry peers. Indeed, at 73% of the first half of 2021 we can see even greater benefit of the cost focus exercise that we implemented through the very challenging low price oil market conditions experienced throughout 2020. Absent the extra costs that we are incurring in the field to ensure a COVID-19 safe environment for our workforce and continued generally uninterrupted operations, our operating costs continue to fall and continue to contribute to that increasing operating margin. All in all, what we are seeing in this half year is the result of high-quality assets, a focused workforce, and an ongoing commitment to delivering value for all shareholders and other stakeholders.

The strategy, our strong portfolio of world-class assets, our strong production and financial results are all underpinned by our commitment to and support for the communities within which we work. In both Papua New Guinea and Alaska, we are very proud of both our economic and social contributions to the respective communities. In PNG, we are the operator of all the producing oilfields there, operating across a million hectares of land and five provinces. We contributed in excess of $450 million in socioeconomic benefits to PNG in 2020. Most importantly, our PNG team comprised of close to 90% PNG citizens and work in close partnership with government and community agencies to not only operate these fields safely, reliably, and sustainably, but through the Oil Search Foundation contribute to better health, education, and gender equality outcomes for PNG.

In Alaska, 75% of our team have been hired from within Alaska itself. We are the second largest oil and gas leaseholder in Alaska, and phase 1 of our Pikka project is expected to deliver in the order of $7 billion in taxes and royalties to the state and native landowner companies over time. More than 60 environmental studies informed the Pikka project design and this has assisted in positioning the project in the lowest quartile of greenhouse gas intensity oil projects around the world today.

With that, I'll hand over to the team to take you through the financial and operational aspects of today's results, and I will come back to finish off with a look-forward at the end. Beth, over to you.

Beth White: Thanks very much, Peter. Good morning, everybody. In the first half of 2021 we successfully delivered significant earnings growth compared to the first half 2020, delivering a net profit after tax of $139 million. This was driven by a 7% gain in revenue, reflecting an increase in oil and condensate pricing over the half and strong production volumes despite the impact from a five-week planned maintenance shutdown at PNG LNG.

Oil and condensate price recovery has boosted calendar year first half revenue to $668 million but while we saw an increase in realised oil and condensate prices of over 80% from first half 2020, approximately 70% of the Group's revenue is derived from LNG and gas, which saw a decline of 5% of the average realised LNG and gas price on the prior corresponding period, reflecting the lag effect of realised prices.

Our commitment to lower costs saw a 6% reduction in production cost from the first half of '20, including the cost impacts from COVID-19 and other one-off costs of approximately $19 million, which contributed to the total production cost of $143.1 million. As a result of our strategy to focus on our core assets, we saw a 90% reduction in exploration cost expensed, while we incurred $7.4 million of hedging cost in the half.

As previously disclosed, we introduced a level of commodity price hedging into our strategy to reduce the downside exposure to oil price volatility, and in the half, we were able to participate in the oil price upside from our hedged floor price of $55 per barrel. Finance costs were also down due to our reduced debt position after we repaid some $290 million in debt and due to the lower costs of borrowing generally.

Accompanying these solid financial results is the highest level of free cash flow achieved by Oil Search since before the 2018 PNG earthquake. We achieved strong free cash flow of $284 million in the first half of 2021 and delivered a free cash flow breakeven price of approximately $20 per boe in the same period. This has assisted us in reducing our net debt position by $254 million to $2.12 billion in the latest six months from approximately $2.4 billion six months earlier.

We maintained a solid cash position at 30 June 2021 of just over $500 million, which together with undrawn facilities provides us with total liquidity of $1.2 billion at the end of the period. During the first half, Oil Search repaid $191 million of PNG LNG debt and $100 million of corporate debt. As a result of net debt reduction, our gearing decreased from 29.9% at the end of December 2020 to 27.2% at 30 June 2021. Overall disciplined capital management has bolstered the Company's balance sheet and we remain focused on improving our financial strength to deliver on our various expansion and growth projects in PNG and Alaska.

Oil Search has an ongoing focus on balance sheet strength. As we have noted previously and per the graphs of debt repayment and facility expiry, we expect the non-recourse PNG LNG debt to be repaid by the end of 2026. At 30 June 2021, Oil Search had $900 million of committed bank facilities with approximately $200 million drawn. The $600 million syndicated facility, which expires in June 2022, was undrawn at 30 June 2021 and subject to final approvals, will be refinanced in the second half to push the expiry date out to December 2026.

During the six months to 30 June 2021, total liquidity decreased by $235 million, mainly as a result of the repayment and cancellation of $300 million of short-term facilities. Strong operating cash flows of $354 million generated during the period were principally used to fund debt repayment of $291 million. Oil Search continues to work on a more robust and flexible balance sheet that acknowledges and counters commodity price volatility during our upcoming growth phase.

We are committed to a sustainable future and in this respect the last six months has been amongst the busiest for the Company as we strive to ensure all operations are managed safely and the wellbeing of our employees, contractors, and communities are maintained even though the pandemic has imposed restrictions on the movement of people and resources. Our commitment to sustainability and transparency has been reinforced with the release of an updated HSES policy and management standard, the launch of our human rights and sustainable communities policies, and registration of our first modern slavery statement.

Oil Search has an ambition to be net zero by 2050, and while we don't have all of the answers today, we are working diligently toward a roadmap to meet that ambition. Work on our carbon abatement program in the PNG business unit continue, including the planned return to service of the thermal oxidiser at our Gobi facility in the second half.

More initiatives are planned for the remainder of 2021, and while these projects may seem small they are important to making our existing production facilities the best they can be and will contribute toward our commitment to reduce our operated GHG intensity by 30% by 2030.

I will now hand over to Diego to take through activities in PNG.

Diego Fettweis: Thank you, Beth, and good morning, everyone. The strong results presented by Beth and Peter were reflected through the fantastic business we've got in PNG. Starting with operated assets, we are delivering against our safety, production and cost targets. Total oil production in the first half of the year was 1.42 million barrels, up 3% versus the same period last year.

Maintaining our strict focus on safety is critical to the wellbeing of our people and operation and in the context of COVID we have shown extraordinary resilience and have managed to avoid impact from COVID on our production. It is fair to say that Oil Search has been an industry leader in establishing a system to allow staff to fly in and fly out of PNG from Australia.

We have also continued the good work on cost reduction efforts which has enabled us to keep our costs broadly flat despite incremental cost related to COVID, including quarantine allowance, emergency response, critical manpower redundancy, medical staff, delay of activities, among many challenges. More broadly, we have progressed our operational excellence initiatives resulting in improvements to process safety, maintenance, and reliability.

Moving on to PNG LNG where production has averaged 8.24 million tonnes per annum for the first half of the year, approximately 20% above the original nameplate capacity of the project. This was achieved despite planned maintenance work which the operator was able to complete one week ahead of the schedule. With increased oil prices we have also realised higher LNG prices under our mid and long-term SPAs in the second quarter and this trend will continue to strengthen in the next quarter due to oil price lags in our contracts.

Overall, our strategic performance across both operated and non-operated business has resulted in production of 13.5 million barrels of oil equivalent for the first half of this year at a unit production cost of $10.63 per barrel of oil equivalent. Average LNG price for the first half was $7.85 million Btu and most notably, realised oil and condensate prices have rebounded from $35.95 in the first half of 2020 to $64.56 in the first half of this year.

Regarding our key growth project in PNG, we also continue to make significant progress on Papua LNG and we now have a clear line of site to FEED entry in the first half next year. Having performed very strongly to date, PNG LNG is also well positioned to continue to do so over the coming decade. The joint venture recently made a final investment decision on Angore and the project is now progressing towards first gas in 2024. This is expected to contribute to maintaining plateau production until 2027.

Moreover, as we are also looking at firming up supply options beyond 2027, the joint venture has approved the budget for the initial stage for the Associated Gas fields optimisation project. This Oil Search operated project consists of increased gas export out of the central processing facilities and gas export out of the global processing facilities, APF where all the Associated Gas is currently being reinjected.

It is worth highlighting the importance of Oil Search operated Associated Gas production to the PNG LNG project, given Oil Search operations are anticipated to contribute almost 25% of the total gas supply to PNG LNG by 2028. Looking further ahead, the combination of Hides, Angore, and the Associated Gas fields is expected to provide a sufficient resource base to maintain the high utilisation rate of the LNG trains beyond 2030.

In addition, we are already working towards adding optionality to backfill PNG LNG into 2030. Firstly, we are supporting the P'nyang operator in their efforts to reengage with the government to progress discussions on the P'nyang gas agreement. Besides P'nyang, we also plan to mature additional backfill options, one of which is the Hides footwall. This is a highly attractive new field for opportunity which we see being appraised after the Angore well campaign is completed.

Moving to an update of the flagship Papua LNG project. The outlook is positive and we are encouraged by the progress made this year. As you can see in the table on the left, the steps completed so far show a steady march towards FEED entry in 2022 and we flag the importance of government support and joint venture alignment. A revised budget for pre-FEED activities was recently approved and this will allow for contracting activities, updated engineering, and basis of design studies ahead of FEED entry in the first half 2022.

Both downstream and upstream project teams are being remobilised, and a key focus area of this phase is to continue to drive costs down and optimise integration with PNG LNG infrastructure. In that respect, I am pleased to report the negotiation of the integration agreement between PNG LNG and Papua joint ventures have now recommenced.

Finally, let me conclude with a few observations of the LNG market. We continue to see growing direct customer interest for rich LNG out of PNG expansion as it provides exactly what buyers are looking for, namely a new low-cost brownfield expansion within the Asia Pacific region that is also a diversification of an already highly reliable LNG project operated by a world-class operator.

Recently, benchmark spot LNG prices have reached multiyear highs in Asia and Europe. These high spot prices combined with a lower liquefaction utilisation rate at some LNG projects which curtailed production just when the market was at its most needy has been a useful reminder to all players that long-term oil-linked LNG contracts will provide a foundation for a growing market going forward.

We continue to observe multiple signposts pointing to a doubling of LNG demand by 2040. Asia is a key driver behind this growth. In 2021 China became the world number 1 LNG consumer and overtook Japan as the largest single LNG importer. As countries reaffirm their net zero ambitions to move their economies toward an energy transition to lower-carbon use, we view LNG and gas as key basal fuels that are entirely complementary to renewables. Therefore, we have confidence that the future of LNG and gas is unambiguously positive.

I look forward to sharing further updates with you on one of the most promising LNG projects in the future. Thank you and I'll now hand over to Bruce for an update on our Alaska activities.

Bruce Dingeman: Thank you, Diego. I'm pleased to share an update on our Alaska business and Pikka project. Our core landholding lies on the north slope of Alaska and is situated near a regulated pipeline with good takeaway capacity. We're situated in a mega-basin underpinned by three world-class source rocks. Key stakeholders, including the state of

Alaska, have benefited from the oil and gas industry's long and successful presence here. We have assembled a high calibre team with deep global oil and gas experience, combined with specific North Slope project development and operational expertise. Together with the capabilities of our joint partner, we are well-positioned for executing our project plan.

The resource base that we have established through extensive exploration and appraisal drilling activities is world-class. The volumes cited here are underpinned by independent third-party certification. These figures reflect our certified volumes on a 2C basis for Alaska, within the Pikka unit, and for the Phase 1 development area respectively. We have secured major permit approvals, including surface access privileges, from Kuukpik via a landmark land-use agreement and a US Corps 404 Permit Federal Authorisation.

On the right side of this slide, please notice where our Pikka Phase 1 project ranks amongst other greenfield development projects according to analysis by Wood Mackenzie. This top quartile position, along with our solid project economic measures, makes Pikka a compelling investment in the energy transition era.

We have established ourselves as a capable operator on the Slope through execution of a significant multi-year exploration and appraisal drilling program as well as completion of a very large civils program. Both of these programs were done without major safety or environmental incident and were completed on time and on budget. This capability positions us well for the next stage of Pikka project development and execution.

We adopted a phased development concept which significantly reduces initial capital requirements and allows subsequent expansions to be funded with established cash flows. Our project has been materially de-risked from both subsurface and cost standpoints. Our appraisal program included a full complement of seismic, wells, cores, logs, tests and integrated reservoir analysis. From a cost perspective we have sought to reduce risk and level load our work program to a contracting approach that will include approximately 70% of the surface scope including facilities, pipelines and other above-ground equipment, tendered under fixed price contract structures.

We have assembled a snapshot of quotes taken from various independent third-party assurance reviews of our project. These offer further support that the appropriate steps have been taken to minimise risk. The project is well-placed for delivery, with civils infrastructure for Phase 1 already in place. The team we have assembled has the capability and depth of experience to reliably execute it.

We entered FEED on the Phase 1 Pikka project early this year and are now nearing completion of that work. We have advanced engineering and design of our modularised processing facility, seawater treatment plant, drill site facilities and operations centre. Our contracting process is progressing to plan, and we will be positioned to begin key contract awards following FID. Our permitting process is well in hand and linked to our project execution schedule. Individual discipline technical assurance reviews are complete, and we are now advancing through the integrated functional review for the project. These internal reviews sit alongside the various key external third-party reviews, as previously mentioned.

Our key project attributes are in line with previous estimates, as our economic metrics are shown on the display of greater than 20% IRR, less than $40 per barrel breakeven cost of supply, including a 10% return. These returns are driven by the approximate 400 million barrels of 2C resource figure and associated 80,000 barrel of oil per day plateau production rate.

Our focus now is to reduce ownership levels across the project through equity selldown and infrastructure funding options, while satisfying the capital requirements. Once these items and the necessary partner approvals are secured, we will be clear to take FID for Phase 1. With that I will turn it over to Peter. Thank you.

Peter Fredriksson: Thanks, Bruce. I think I can safely say that what you have seen from the team this morning is a strong financial result from a world-class portfolio of assets that will clearly deliver both ongoing profitability and growth for many years to come. In PNG and Alaska we have significant assets and significant positions within those assets such that our shareholders can expect to see strong returns into the future.

So to sum up, we have made good progress with our strategic priorities in 2021. Our cost control programs are well advanced, albeit with some COVID-19 impacts in 2021 that we would hope can be taken out in 2022 and certainly by 2023. Our cash flows are strong and delivering ongoing reductions in debt in the business, whilst also supporting organic growth in the PNG oil business and rewarding our shareholders for their ongoing support.

We have two world-class projects in front of us that will deliver longer-term growth to the business. Papua is looking to a FEED decision in 2022, and first gas in 2027. Pikka is a world-class asset. We are continuing to work with our partner, Repsol, on putting in place the right funding structure either from an equity or an infrastructure selldown, or possibly both so we can go forward with the project with an appropriate level of risk into the longer-term.

We have a balance sheet that is growing in strength as a result of as much as $500 million a year in PNG LNG debt repayment. All underpinned by ever evolving and maturing programs around sustainability with realistic and achievable GHG intensity targets.

The solid first half financial results have put us in a position to work through the rest of the fiscal year 2021 with an expectation of delivering similar strong metrics over the full year. Strong operational performance in PNG, underpinned by PNG LNG, and strong third quarter lag pricing are expected to maintain margins above 70% in the second half. If, as we have to date, we can keep COVID-19 substantially out of our field operations in PNG, we expect FY21 production to settle well within the 25.5 million barrels to 28.5 million barrels of oil equivalent range and unit production costs within the $10.50 per barrel to $11.50 per barrel of oil equivalent range.

Our cash flow continues to look strong, giving us further confidence in being able to deliver total dividends for the year within the 35% to 55% of core NPAT range.

Oil Search is a business with what we believe is fabulous growth potential. In talking about that, I'd like, I start by saying this. With some 1280 employees in Oil Search today, less than 50 of them are working, working very hard I might add, on the Santos merger proposal. The other 1230 are working very hard every day for Oil Search shareholders, delivering the results that we have tabled today in the extremely challenging environment that COVID-19 is delivering to us all. In Papua New Guinea, in Alaska, and in Australia. They are doing that every day without thinking about what the result of the Santos merger proposal will be because they know they work for Oil Search's shareholders today. They will continue to do that if we are a standalone business in the future.

They are working on projects and assets that we think can deliver in the order of 50 million barrels of oil equivalent in production per annum. $2 billion-plus annually in EBITDAX, and $1.5 billion to $2 billion per annum in free cash flow by the end of this decade. Clearly these numbers are projections of future outcomes that cannot be guaranteed. But Oil Search is a business our people are proud of today, and proud to continue to grow into the future.

With that we will finish the formal part of the presentation, and we will be happy to move to questions. Thank you.

Operator: Thank you. If you wish to ask a question, please press star-one on your telephone and wait for your name to be announced. If you wish to cancel your request, please press star-two. If you are on a speakerphone please pick up the handset to ask your question.

The first question comes from Tom Allen from UBS. Please go ahead.

Tom Allen: (UBS, Analyst) Good morning all, a question for Diego. Just following up your comments in ExxonMobil and the PNG government setting a plan in place to potentially work towards a P'nyang Gas Agreement. Does this update suggest any change to the plan for P'nyang to backfill for the existing two-train development beyond 2030? Are you flagging a likely change to the CapEx sequencing to develop P'nyang?

Diego Fettweis: Good morning and thanks for the question. Look, our position has been very clear regarding P'nyang. We see P'nyang as the backfill to PNG LNG and that has not changed. I would refer back to the comment that Mr [unclear] made on Friday, that he saw the phased development of Papua followed by P'nyang as a boost to the economy in PNG. That very much aligned with our position of P'nyang as a backfill to PNG LNG.

Tom Allen: (UBS, Analyst) Okay, thanks, Diego, that's clear. Just a question quickly for you, Peter. I just wanted to confirm under what circumstances, if any, the merger ratio that Oil Search has agreed with Santos could be re-evaluated and renegotiated?

Peter Fredrickson: Well, Tom, as you'd expect we're both of us going through a process today that is geared towards confirming that agreed exchange ratio. I suspect if there was any material departure from the inputs that delivered that initial exchange ratio there might be some discussions beyond that. But as we sit here today, we have not talked about that. We are all doing the due diligence work that we would expect to do. We'll address that when we get to the end of that, and before we enter into the MID.

Tom Allen: (UBS, Analyst) All right, thanks Peter, thanks Diego.

Operator: Thank you. The next question comes from Gordon Ramsay from RBC Capital Markets. Please go ahead.

Gordon Ramsay: (RBC Capital Markets, Analyst) Well, thank you very much. Just a question about the deferral of the CPF maintenance that was supposed to take place this year. Just trying to understand what impact it'll have next year on the operations, and if you can give some update on the timing for it, please?

Peter Fredricson: I might push that one off to Diego.

Diego Fettweis: Good morning, Gordon, thank you for the question. Look, in terms of the timing, we are looking at having it carried out some time in the second quarter next year. In terms of the impact, that will be provided as part of the guidance for next year.

Gordon Ramsay: (RBC Capital Markets, Analyst) Okay, thank you. Just one more from me, Beth, just on other operating costs. They reduced strongly year-on-year. Can you just kind of highlight the key drivers behind that reduction? Was it overheads, corporate cost?

Peter Fredricson: Beth?

Beth White: Sorry, trying to take myself off mute. Can you please just repeat the question?

Gordon Ramsay: (RBC Capital Markets, Analyst) Yes, there was a very strong reduction in other operating costs year-on-year, I think it was down 40%. Just wanted to understand what the key drivers were behind that. Was it corporate costs, or another area?

Beth White: So are you referring to production cost?

Gordon Ramsay: (RBC Capital Markets, Analyst) No, production costs is fine. It was other operating costs.

Peter Fredricson: I think we're a bit interested in the 40% number, Gordon. I think what we were talking about is we've got a target of 40% of operating costs between from 2019 by 2023. But I don't think we have achieved an outcome of that in this first half. Why don't we look at that and come back to you on it?

Gordon Ramsay: (RBC Capital Markets, Analyst) Okay, thank you.

Operator: Thank you. The next question comes from Nik Burns from Jarden Australia. Please go ahead.

Nik Burns: (Jarden Australia, Analyst) Yes, thanks, Peter and team. Just a couple of questions in relation to the Alaskan sale process. On the Santos results recently they said they were very supportive of your sale process. But they also said, they aren't as wedded to operatorship as Oil Search has been historically. Just wondering if you have included operatorship as an option in your sale process? Thank you.

Peter Fredricson: Nik, at this stage we're not really in a position to talk about the selldown process specifically. I mean we will confirm that it's ongoing, and we will confirm that we have had engagement with a number of parties in respect of it. But from our perspective I think that we are not, we Oil Search, are not wedded to any one particular thing. That would include operatorship.

It comes down to what makes sense for us in the context of whatever proposal might be put in front of us. So we will get to a point where we will assess outcomes based on value for Oil Search, value for Oil Search to shareholders, and we'll move from there.

Nik Burns: (Jarden Australia, Analyst) Okay, got it. Just my other question, if I put myself in the shoes of a prospective buyer in Alaska, I would clearly be aware that there as a proposed merger underway between yourselves and Santos. Whilst there will be some expectation that the people on the ground would be largely unchanged through that process. I would have thought that any prospective buyer would want to engage with Santos about their approach and whether they plan to make any changes to Pikka Phase 1. Just wondering, has Santos been involved in this process at all to give prospective buyers some comfort around continuity and consistency of approach? Or is it still too early for that? Thanks.

Peter Fredricson: Nik, Santos and ourselves are only in a period of exclusive due diligence at this point in time. We don't have anything other than an indicative non-binding merger proposal on the table. So the answer to your question is that Santos have not been involved in any of, any discussions or any direct communication with anybody in respect of what we do whether it's Alaska-related or PNG-related.

So they're clearly, if we proceed beyond the position we are in today those, we likely reach agreements that enable that sort of thing to happen. But that will be very much dependent on what the merger implementation deed looks like, if indeed we get to that point.

Nik Burns: (Jarden Australia, Analyst) That's clear, thanks, Peter.

Operator: Thank you. The next question is from James Redfern from Bank of America. Please go ahead.

James Redfern: (Bank of America, Analyst) Oh, hi, Peter and team, good morning. Just maybe two questions on Papua LNG please. Just can you please talk a bit more, in a bit more detail about the steps required to enter FEED in the first half of next year for Papua LNG? Just so I can better understand the various steps involved there.

Then the second question is just in relation to LNG marketing for Papua LNG. Just wondering, have Oil Search had any sort of fairly advanced discussions in terms of LNG marketing? Can you sort of comment on pricing for slopes at the moment, are they still around 10% to 11% to Brent? Thanks.

Peter Fredricson: James, to the extent that we can comment on some of those questions, I'll handball it to Diego, he's our man for that.

Diego Fettweis: Good morning James, and thanks for the questions. So I'll start with the FEED question you asked. Look, very much focused, it's going to be very much focused on further optimising the integration with the PNG LNG infrastructure. So we have done already a fair bit of work there. The work that we are looking at doing in pre-FEED is going to be firming that up.

You would also expect that there would be some update to the base of design following the pivot that we have had on three-train to two-train. So that's also going to require some additional work. Then also going ahead with the contracting activities that we need to do anyway to get into FEED.

On top of that we will be looking at all additional options that we have got, opportunity we have got to further reduce our carbon footprint. Looking out for an offset, as you would expect. We definitely very much will be striving for that. We have got very strong alignment with Total and with ExxonMobil on that as well. So that's probably going to be the biggest focus. That I am going to update on the technical side and the commercial side, as we have indicated that we will also, we will be looking at executing the relevant integration agreement ahead of FEED. Also for that very reason that we have already restarted the negotiations between the PNG and PNG [LNG] and the Papua joint venture. That answer you first question?

Nik Burns: (Jarden Australia, Analyst) Yes.

Diego Fettweis: With regards to energy marketing, look, it's very important for us to first have this line of sight for FEED. It's really when we are about to enter FEED and shortly thereafter that we will have the - we will be making the largest progress when it comes to the relevant agreement. We would be looking at targeting a head of agreement shortly after FEED. So at the moment what we're looking at is phased re-engagement with our buyers and users, traders.

We were every well advanced before the COVID-19 crisis hit. We were looking at a very different concept at that time, looking at marketing much more volumes. We had some really strong engagement and very strong interest from our buyers. While we are seeing that appetite has not changed, and we very much re-engaging and/or as the case may be, continue the engagement with our buyers. Still very much hearing the very strong sentiment about Papua.

Nik Burns: (Jarden Australia, Analyst) Okay, Diego, thanks a lot.

Operator: Thank you. The next question comes from Dale Koenders from Barrenjoey. Please go ahead.

Dale Koenders: (Barrenjoey, Analyst) Morning, guys, a couple of quick questions building on from others. On, Peter, I know you don't want to say too much on Pikka. But can you give us an indication of when you are anticipating bids? Or when that process could close on both the infrastructure monetisation and sale and the project?

Peter Fredricson: Dale, one of the reasons why we pushed away from, probably in the last sort of six months we pushed away from this date that we had put into the market of 1 November FID. It was because we didn't want to put ourselves into a position where we were constrained by a date for either an equity selldown or an infrastructure monetisation. So as we said here today, all these sorts of processes whilst they have indicative timetables, they do become dependent on third parties and what they have got by way of internal processes to get through.

We have in my experience over many years dealt with counterparties that have internal processes of three months to six months to get things approved. We don't want to rule people or entities like that out of our process. So we're not going to talk about dates in respect of Pikka. What we will continue to do is, we will continue to engage with counterparties as we are doing today.

The other thing I'd say to you is that, I think maybe Nik mentioned it, at the end of the day the Santos merger proposal is always likely to slow counter-parties up. Because what third parties want to understand in that context is what they are getting. Are they getting the same outcome as might have been discussed with us through the process? So as we said here today, if we receive something during this year, we will asset it. We will deal with it in the way we are able to deal with it at the time. If that's governed by a merger implementation deed with Santos, we will asset it in that context. But if we don't, well, we will work through the Santos proposal and see where we are at the end of that.

Dale Koenders: (Barrenjoey, Analyst) Okay, thank you for that clarity. Second question, just you mentioned the Associated Gas budget had been agreed by the joint venture. Can you tell us, what is the CapEx cost for that next stage of effectively backfill gas?

Diego Fettweis: Thank you for your question. So this is Diego Fettweis here. Look, that's included in our guidance in terms of the sustained CapEx. I believe we will share that guidance during our Investor Day in November. Very much aligned with that guidance. What we are look at, at this stage, is of course very small amount of money to kick off the initial work, as I indicated earlier.

Dale Koenders: (Barrenjoey, Analyst) Okay, thanks.

Operator: Thank you. The next question comes from Saul Kavonic from CS. Please go ahead.

Saul Kavonic: (Credit Suisse, Analyst) Thank you, folks. I just want to kind of touch on I think a point Nik raised earlier. Peter, have Oil Search pursued alternative options to the merger? Such as for sales of Alaska and PNG LNG.

Peter Fredricson: Saul, no, we haven't. We haven't explored those two matters. What we are continuing to do is, we are continuing to run the business in a way that delivers value to our shareholders. As we said here today, we are concentrated on a process where we have agreed an exclusive due diligence right for a period of time with Santos. Out the back of that we will see where we get to.

Saul Kavonic: (Credit Suisse, Analyst) Thanks. I mean I guess is there a reason Oil Search has not pursued any other potential sale avenue? Whether it's to another party or on an asset basis, and just potentially accepted the first offer that's been put on the table?

Peter Fredricson: Well, look, we haven't accepted the first offer that has been put on the table and in fact we assessed an earlier approach from Santos and rejected it as solely unacceptable in the context of value and that's been well discussed I believe in the media. What we are doing is we are engaging with an entity that's come to the table and we will continue to do that to the value of our shareholders.

Saul Kavonic: (Credit Suisse, Analyst) Thanks Peter. That's all from me.

Operator: Thank you. The next question comes from Daniel Butcher from CLSA. Please go ahead.

Daniel Butcher: (CLSA, Analyst) Yes, hi everyone. A couple of project finance nerd questions from me please. Just curious, firstly, for Papua LNG you restarted the project finance activities, can you give an indication, do you still think you can get 70% of CapEx debt funded with project finance or is more like 50% or 60% these days in Papua New Guinea?

Peter Fredricson: Look, yes, I'll take that one on Daniel rather than throwing it to anyone else. I think that, as we have said here today, we are very confident in the project financing process for the Papua LNG project. It's a very well-advanced process. It's a strong team that had been quite well advanced until effectively the benching, if you like, of the project about 18 months ago and I suspect that I could say that of the project teams at that time, the financing project team was the most advanced of all of them in respect of that project. As we sit here today, I don't think we have made any decisions as to what we think the number might be, whether it's one number or another, but the project finance team across Exxon, Total and Oil Search is working very hard and well advanced in the context of that project.

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Daniel Butcher: (CLSA, Analyst) Okay, thanks. I might try on the Alaska angle then, just on the infrastructure monetisation angle you are working on. Would that be sold at - what sort of facility of scope is that going to be over exactly in terms of maybe dollar value or type of facility and would that be done at the book value of construction or would that be a bit like what you did at APA with QCLNG and a multiple of the value of the construction kind of sale leaseback type deal?

Peter Fredricson: Yes, it's a good question and you guys will see monetisation of infrastructure, midstream infrastructure, around the globe now it's becoming very popular and I suspect that what you do see is you do see the latter more than the former. Probably the reason for seeing the latter rather than the former in the vast majority of cases is because the infrastructure is already built. What we have talked about in this context is more of the former where we understand or we agree what needs to be built and in some form of an open book process the funding of infrastructure by a counterparty, or by someone we agree with on a deal, that they will fund the build of the infrastructure on an open book process and there will be a return based on various different throughputs.

Now, they're very conceptual concepts. Well, they're very conceptual because we don't have a fixed view. It does not have to be one thing or the other. There can be a number of different ways to do things and that will often depend on the counterparty and what their needs are, but typically in the context of midstream infrastructure it's a tariff, some form of a tolling tariff and a return on capital. In respect of the infrastructure that we are talking about, we've got about, you know, it's a $2.6 billion build on Phase 1 of the Pikka project I think, Bruce, I'm right in that number, about $1.1 billion of that is drilling and about $1.5 billion of that would be what I would call infrastructure. We've talked in the context of between $900 million and $1.2 billion of infrastructure that's downstream of the processing facilities as the opportunity.

Daniel Butcher: (CLSA, Analyst) All right, that's really helpful. Can I ask just one more nerd question? Can you just confirm that the CFADS calculation, you take out the whole lease liability and therefore you get an uplift of like 0.5 over times on DCSR? Is that how you think about it?

Peter Fredricson: No, we don't put the lease liabilities into the CFADS at all.

Daniel Butcher: (CLSA, Analyst) Right, okay. All right, thank you.

Operator: Thank you. The next question comes from Baden Moore from Goldman Sachs. Please go ahead.

Baden Moore: (Goldman Sachs, Analyst) Good morning Peter. Thanks for taking the questions. Just on PNG, I was wondering just with the press around P`nyang, how material would it be in your mind and why if you were to get a fiscal term on the development P'nyang before the end of the year? Then just on the Hides footwall project, I was just wondering, does that project fall into the existing PNG LNG fiscal terms or will you need a separate agreement there? Then a bit has been happening in Alaska just on the Willow project. I was wondering how you saw that having any read throughs onto your existing development positive or negative from that perspective.

Peter Fredricson: I'll just - I'll drop that PNG and P'nyang stuff off to Diego. He is just coming off mute as we speak.

Diego Fettweis: Yes, indeed and thank you for your question. Look, it is definitely very positive in terms of P'nyang and it is really important to get that clarity I believe early on and we are definitely seeking to first of all secure the fiscal terms that is going to enable us to progress the project and also secure the licence tenure as part of the process. That was in relation with P'nyang. You also asked a question about the Hides footwall and the Hides footwall will fall under PNG LNG fiscal terms as agreed under the gas agreement and the fiscal stability agreement.

Peter Fredricson: So, Baden, I think that got the first two parts of your question. There was a second or third part of your question. I might have missed that.

Baden Moore: (Goldman Sachs, Analyst) Yes, I was just wondering with the Willow updates from last week whether there were any positive or negative read throughs for how you would approach Pikka going forward just with the court ruling against it.

Peter Fredricson: Look, honestly, we are not really wanting to comment on things that happen to our neighbours. That's for them and I am sure they will continue to work through what they've got to do in respect of their own project. I think that what we have outlined and I will throw this to Bruce, I think what we have outlined in the context of our proposal or our presentation today and what we have continued to do all along is to highlight the positives of our own project. I think that Bruce can explain to you what we have got and how we are not impacted by the things that Willow might have been. Bruce, can I throw that to you.

Bruce Dingeman: Sure, can you hear me okay?

Peter Fredricson: Yes, good, yes.

Bruce Dingeman: With regards to the court's decision on the Willow EIS we really can't comment on Conoco's behalf, but our circumstances are a bit different than that. Our project resides on state not federal land. Additionally, our EIS was issued some time ago and since that time we have already installed gravel or we have put our road base pads and other infrastructure in place for their civils program, so the likelihood of a challenge as a consequence of that is much less than a project that didn't have that maturity or that sitting on state land.

Peter Fredricson: Baden, hopefully that covers that one off for you. Again, we see what we are doing there as very positive in the go forward.

Operator: Thank you. The next question is from Mark Samter from MST. Please go ahead.

Mark Samter: (MST, Analyst) Yes, morning everyone. A question for Diego if I can. Diego, when we look at slide 18 about Papua's progression towards FEED and FID, obviously the in-progress ones are effectively negotiations with PNG LNG. I would think most people would agree one of the great attractions of the merger between Santos and Oil Search is that it does probably create the prospect of being in a position to greater align Papua and PNG LNG from an equity ownership perspective. Is there an element where your potential merger with Santos has put a bit of a pause on the negotiations between PNG LNG and Papua because the playing field could look quite different post-merger if you can get greater alignment across the project?

Diego Fettweis: Good morning Mark and thank you for the question. Look, first of all, what we can say is that we have reinitiated those negotiations and they are progressing well and so we definitely haven't noticed any of what you just raised and we wouldn't expect that to be the case. There is definitely some benefit for everyone involved here and on the PNG LNG, as well as the Papua side, to continue those discussions. We always highlight the benefits from a Papua point of view but we also need to emphasise how much PNG has to benefit from being able to leverage the unused capacity that there is on the PNG LNG side and to be looking at sharing some operating costs in the future as well as receiving an access fee. That will definitely be benefiting Santos in any case no matter what happens with the merger.

Mark Samter: (MST, Analyst) Okay, I guess fair to say commercial logic will dictate that ordinance negotiations are a hell of a lot easier if you did end up in a scenario where the operator of Papua is also an equity owner in PNG LNG?

Diego Fettweis: Sorry, I didn't really get the question. The quality of the line is not the greatest. Could I ask you to repeat the question, Mark?

Mark Samter: (MST, Analyst) Oh sorry. Yes, I was just going to say, commercial logic would dictate that these negotiations would be a lot easier if Total as operator of Papua did also have equity in PNG LNG. Just the closer the alignment the easier these things are to progress. Do you think that's a fair interpretation?

Diego Fettweis: Yes, that is absolutely a fair interpretation. The more alignment you have got on the partners on the joint venture side the easier of course the negotiation. Yes, absolutely, that's very commonsensical. Yes.

Mark Samter: (MST, Analyst) Thanks and one question if I can quickly and again, I don't want to try and get you to speak on behalf of Exxon and Total, but when we think about what Mozambique is causing to their LNG portfolios looking forward and I guess there has always been a view that the challenges or such could have in marketing these volumes that maybe those guys provide a bit of a backstop for your volumes, that they would take your volumes if they couldn't be sold elsewhere. Do we think we're in a world where there's a bit more urgency of those for Exxon and Total, yes, to progress the projects, but maybe even from a portfolio perspective that your equity share of the gas could be in slightly hotter demand than it was previously?

Diego Fettweis: Again, could you please - what's precisely your question here? I mean…

Mark Samter: (MST, Analyst) Yes, sorry.

Diego Fettweis: Yes, I mean I can definitely answer the question in terms of whether or not Exxon and Total could be purchasing our volumes and that would be of course a possibility. That's something that we are contemplating. We just want to make sure that we are extracting maximum value for our volumes. Since the joint venture decided that it would be an equity lifting model as far as the Papua project is concerned, Oil Search will be marketing their equity of the volumes. That's a question that we regularly receive and it will have to go to where we get the highest value for, but I thought your question was about something else.

Mark Samter: (MST, Analyst) Yes, sorry, it was an awful waffly question but you have kind of answered it and I will stop taking up your time. Thanks, Diego.

Diego Fettweis: No problem at all. I think the quality of the line was not really helping us. Thanks for your question Mark.

Mark Samter: (MST, Analyst) I think it's mainly my fault, not the quality of the line. Thanks, Diego.

Diego Fettweis: Thanks Mark.

Peter Fredricson: Thanks Mark. What I wanted to go back to was a question that Gordon asked about other operating costs being down by 40% and we were a bit thrown by the down by 40% number other than the fact that it is. That was the objective that we set out with last year to reduce other operating costs by 40% between 2019 and 2023 and we did say that we were on track to do that, absent COVID-19 costs. Beth has got a bit more clarity if you like around the actual results where I think our costs are up $20 million, not down. Maybe if I throw to Beth, she can answer that question in the context of what actually happened rather than simply being down 40%.

Beth White: Yes, so I guess I would start by saying I would encourage for the question to be re-asked to make sure we are answering the right one, but in terms of other costs of production, they increased by $13.2 million. That was largely due to unfavourable inventory movements, of course higher royalties and levies [inaudible] filters higher commodity prices and this is partially offset by lower gas purchases related to the [shut in as the high test] electricity project. Of course, I already mentioned the $7.4 million of hedging costs in the half. Hopefully that is responsive to the question, although again, we would encourage the question to be asked again if that doesn't satisfy.

Peter Fredricson: Or we can chat about it later on Gordon in our call this afternoon, so happy to hand back to the moderator.

Operator: Thank you. The next question comes from Simon Mawhinney from Allan Gray. Please go ahead.

Simon Mawhinney: (Allan Gray, Analyst) Hi, good morning or afternoon everyone and just to acknowledge as a shareholder, Saul's questions, I thought they were very good. I had a question relating to the infrastructure monetisation in Alaska. Peter, I am curious how you see this de-risking the project. From a shareholder perspective I see it as substituting financial leverage with operating leverage.

Peter Fredricson: Yes, look, it's a good question Simon and I think at the end of the day what both ourselves and Repsol are setting out to achieve in respect of having a third-party participant in the project is confirmation from a third party of the bona fides of the project. I think that whether it's by way of an equity selldown or whether it's by way of someone putting in $1 billion to fund infrastructure, that they will need to receive a return both of capital and on capital over a very long period of time. I don't think we are going to see anybody put that sort of money to work in a project that they're not effectively providing or not effectively having confidence in its bona fide.

At the end of the day, you may be right in one sense, but what we have said is that we are pursuing either or both and again, what we are trying not to do here is to close off avenues of funding to a project that will take risk away from us. I mean effectively at the end of the day someone who is prepared to put in, let's call it, $700 million to $1 billion worth of funding into a project like this takes some of that risk away from our shareholders and Repsol's shareholders, but we will continue to look and see whether or not that is achievable.

Simon Mawhinney: (Allan Gray, Analyst) Okay, sorry, so I think I misunderstood it. So an infrastructure selldown or contribution from an infrastructure party, it wouldn't be guaranteed, the returns of and on capital wouldn't be guaranteed by the strength of neither Oil Search's balance sheet nor Repsol's. It would be non-recourse to headstocks. Is that right? It would just be project specific.

Peter Fredricson: Well, that's exactly what we have seen in the past and that's what my expectation would be. Until I have got something on the table Simon, I can't be 100% certain, but we have our objectives and those are the objectives that we would drive towards.

Simon Mawhinney: (Allan Gray, Analyst) Okay, no that's great. It's just that $1 billion contribution for Pikka where there is a headstock guarantee is not the same as a screaming endorsement of the project.

Peter Fredricson: I appreciate that 100%.

Simon Mawhinney: (Allan Gray, Analyst) Okay, thank you.

Operator: Thank you. The next question is a follow up from Gordon Ramsay from RBC. Please go ahead.

Gordon Ramsay: (RBC Capital Markets, Analyst) Thanks, my question has been answered and I made a mistake, it was other operating costs rose 40% year on year but didn't rise as much as I expected, so that has covered it quite well. Thank you.

Peter Fredricson: Thanks Gordon.

Operator: Thank you. The next question is from Scott Ashton from SHA Energy Consulting. Please go ahead.

Scott Ashton: (SHA Energy Consulting, Analyst) Hi Peter, it's Scott here. Look, I want to just clarify something. The selldown with Alaska, should we be thinking of just a 15% or are you doing it in a lockstep with Repsol because it's not immediately clear whether you are doing some of the heavy lifting for Repsol on joint equity selldown. Could you just maybe provide some clarity around that? I suppose the other thing that is not clear in the presentation, I mean that with all due respect, what is left in terms of regulatory approvals for Alaska? Is there anything outstanding in terms of hurdles you need to get to an FID on this?

Peter Fredricson: I will throw that one to Bruce in a minute but I will talk to you about - I will get to the equity selldown. Oil Search today is the operator of this project and in that regard, we have a mandate from our partner Repsol to work through the equity process and work through an infrastructure monetisation process and work through other funding processes in respect of the project. In that regard, we are in the process of marketing a 15% to 30% selldown. Now, my expectation is that it is a 30% selldown because both of us want to achieve that reallocation of risk or that introduction of a third partner. So we are doing the work, but we are working very closely with Repsol in that regard and we are doing that work as the operator for the project.

In respect of the regulatory approvals, et cetera, I will just throw that over to Bruce. He has got that all on the top of his head for you.

Scott Ashton: (SHA Energy Consulting, Analyst) Thanks Peter.

Bruce Dingeman: Okay, thank you Peter. Yes, just to remind everyone, there is three jurisdictions that apply for Alaska permit approvals, those being Federal, State and Local or Borough approvals. We have all the major process approvals in place under each of those three jurisdictions as well as a significant portion of those that cascade from that, but just to give you some context for the Pikka Phase 1 project, there will be in total probably 700 permits required with monitoring of probably some 3000 plus conditions and stipulations. So a lot of those are - all of those are linked to our project execution schedule. The major processes are in hand, the cascading ones are well advanced and what remains is really linked towards project execution. So we don't see any roadblocks or impediments to moving towards FID based on permit or regulatory approvals.

Scott Ashton: (SHA Energy Consulting, Analyst) That's great. Thank you, Bruce.

Operator: Thank you. There are no further questions at this time. I will now hand back to Mr Fredricson for closing remarks.

Peter Fredricson: Well, thank you very much and look, thanks everybody for taking the time this morning. I think that what we have had in 2021 is a very interesting year in respect of everything that we have faced. We faced COVID-19 in PNG, we are facing a worse situation I think now in Australia, we have faced some changes in the management team here at Oil Search and we have faced corporate actions in our industry, let alone specific to ourselves.

All the way along I think the one thing that we have continued to talk to our people about is focusing on running this business for its shareholders and the one thing that I can bring to this table is experience and knowing that when transactions get put in front of shareholders they don't often or they don't always, sorry, they don't always run the full course and if they don't you've got to have continued to run the business for its shareholders. The one message that we are driving hard with our 1200 odd people in this business is that no matter what is happening out there on the periphery of things, we have got a big business to run and we'll continue to run it and we'll continue to deliver good returns to our shareholders.

With that, thank you all very much. We hope to talk to you individually, either shareholders and analysts, over the coming weeks off the back of these results and clearly as things happen further in the proposed merger proposal with Santos, we will make those announcements as and when it's appropriate to make them. So thank you all very much for your time.

Operator: Thank you. That does conclude our conference for today. Thank you for participating. You may now disconnect.

End of Transcript